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DOW THEORY LETTERS

"THE MARKET AS INTERPRETED UNDER THE DOW THEORY"

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PREDICTION. It cannot be too often repeated that the industrial and rail averages, when "read" correctly under the tenets of the Dow Theory, act as a "barometer" (or forecaster) of future financial conditions. In fact Wm. P. Hamilton, one of the great Dow Theorists and editor of the Wall Street Journal for many years, elected to entitle his classic book, "The Stock Market Barometer." The changing balance between supply and demand for stocks can be observed by means of the daily stock averages. These averages reflect the sum total of everything known by anyone that could possibly affect the economy and therefore the price of stocks. The famous Talleyrand of France once said, "I know somebody that knows more than anybody--and that is everybody." Financially speaking, that "everybody" is the market, which we Dow Theorists happen to measure by means of the two Dow Jones averages. When the majority of the best informed opinion feels that factors favorable to business are in the offing, stocks are purchased and the market advances. Conversely, when this informed opinion feels that conditions are deteriorating, cash is preferred to equity and stocks are sold, thus fomenting a decline.

THREE CAMPS. Economists these days are divided into three camps: 1.--Those who note the present economic upturn and project a gradual but undramatic continuance of better business into 1959-60. 2.--Those who admit to a temporary upturn, but who are skeptical of the quality of the improvement. They expect a leveling out of the economy and perhaps a period of more trouble. 3.--A small group who are tremendously impressed with the upturn, and now see an extremely prosperous period or even a "boom" arising in 1959-60. We Dow Theorists may derive comfort from the fact that historically the averages have been able to predict the figures which our friends the economists will be poring over three months to a year from now. The extremely bullish pattern plotted by the averages as they climb into new high territory, the continual consolidation of each major move (rather than a reaction), and the subsequent breakout, imply as far as this writer is concerned, nothing less than a coming "boom." Hamilton wrote the following in May, 1922, and it is an important idea which is little appreciated at the moment--"The speculation in stocks itself creates exactly the confidence which stimulates an expansion in business." Or in different words--a boom can inflate itself just as a depression can feed on itself. I believe we will see the truth in this statement about the first quarter of next year.

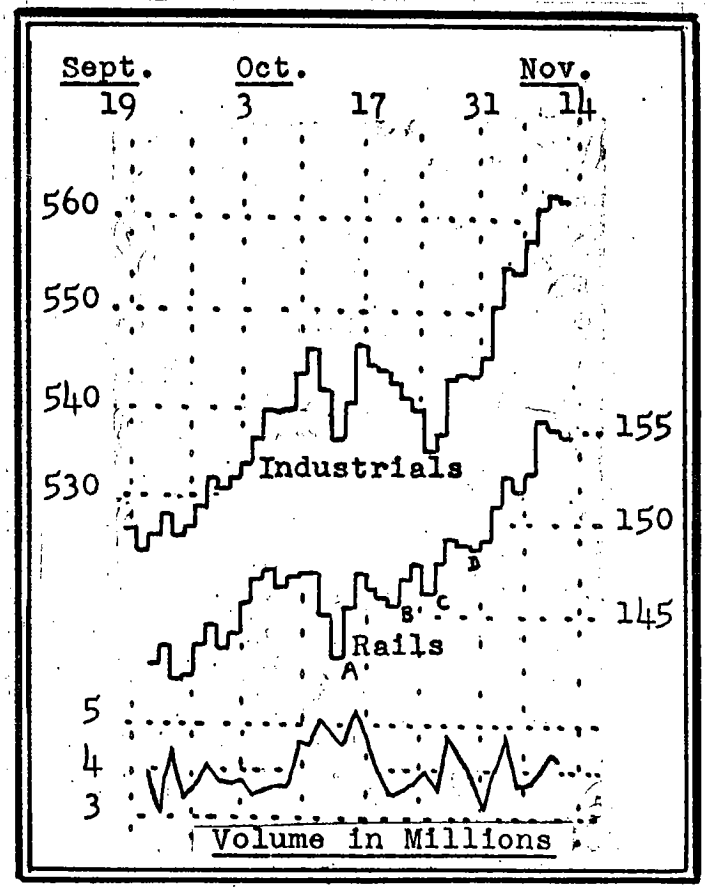
NEWS. Often when a sharp advance was occurring, Hamilton would tell his Wall Street Journal readers that the reasons for an advance were seldom known at the time. He explained that newspapers and analysts who were anxious to please their readers often printed reports on why this or that factor was behind the move. Inevitably, the reasons given had been discounted by the market weeks or months before, and the real reasons might not be known until months later. The old market adage says, "there is no news in a bull market." In other words, the public seldom knows the reasons for an advance in stocks. The newspapers, as a rule, know just as little. "A movement is over," said Hamilton, "when the news is out." It is a little ridiculous to read in the newspapers day after day that this stock rose because of a tip from a service--that stock spurted because of a merger rumor. This writer would like to read in a newspaper some day that a stock "rose sharply because demand exceeded supply--due to some obviously bullish reasons totally unknown to this paper."

DOW THEORY. The remarkable strength of this great upsurge since Oct., 1957 lies in the frequent consolidations which have punctuated the whole rise. After a long advance, reaction becomes the normal expectation. But at times, if the market is technically strong, we will get a consolidation period instead of a reaction. This is exactly what has happened at intervals all the way along in this tremendous thirteen month advance. The

bearishness of the majority of analysts has kept the public from entering or at least remaining in this market. As a result the picture has remained one of incredible strength. Last week we had a complete breakaway as both averages soared to new highs on bullishly increasing volume. Note the four ascending bases (chart--A to D) on the rail average. This is an extremely strong, bullish formation, more so, in fact, than the industrial formation.

SELLING. Many readers are asking "when do I sell my XYZ stock? It has moved 10 points in the last month. Isn't it too high?" This writer trades on the Dow Theory and the implications of the averages. In a technically strong market when the averages are plotting a bullish course, I like to stay invested regardless of whether my emotions tell me that stocks are too "high" or not. Great Dow Theorists like Rhea and Hamilton would warn, after a long advance, that "no tree grows to the sky." This advice has never proved wrong. In this incredible bull market, however, I am inclined to wait out this advance and see what develops. There may be indications before the next reaction, and we can discuss them when they arise. At that point readers who wish to trade within the bull market can "lighten-up." It is well to remember that this year many of the real tax losses are owned by the shorts. They will probably want to take their losses before the year-end, which means they must buy to register these losses! This could bring on a big final rally as '58 closes.

STOCKS I LIKE. Wheeling Steel. Always a late mover, "WHX" at $51 is $19 under its '56 high. Will earn only $3 this year, but is capable of earning $10. A flat steel producer with a highly leveraged capitalization. American Cyanamid. A very diversified chemical company with drugs (Lederle Labs.), Formica, plastics and basic chemicals. Although earnings are down to $2.00 this year from $2.42 last year, "ACY" has a top growth record, and is one of the best buys in the chemical group. Pure Oil. With $110 worth of oil behind each share, "PY" is an outstanding value in the low $40 range. A domestic producer with large South American holdings and plenty of natural gas. I think it will go well over its $51.75 high. Standard Oil of New Jersey. One of the great oil combines with an interest in just about every oil producing area of the free world. This week "J" finally made a new high for the year, but I think it good for $70-80 before this market hits its top. St. Regis Paper. "SRT" expanded too rapidly as did most of the big paper companies. Although earnings were badly hit during the recession they are now turning up sharply. "SRT" is a great one for mergers and growth. They liked it in '56 at $60, why not now at $44?



Wednesday's market was hesitant with industrials advancing slightly on expanding volume while rails declined. Thursday produced a small decline in both averages while volume contracted (see chart.) Volume will now be the clue to the next move. If the decline continues on decreasing volume (indicating an absence of selling pressure), the short-term picture will remain bullish. Contracting volume on sell-offs is usually a bullish sign. This writer does not expect much of a decline or reaction here.

(Written Nov. 13, after the close.)

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